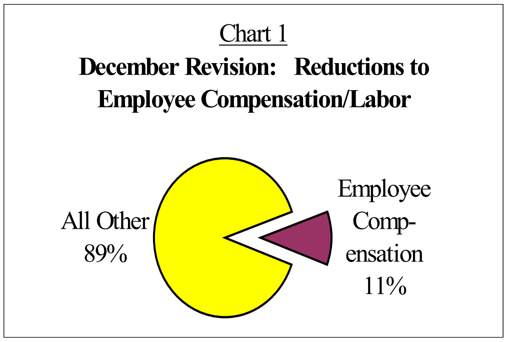
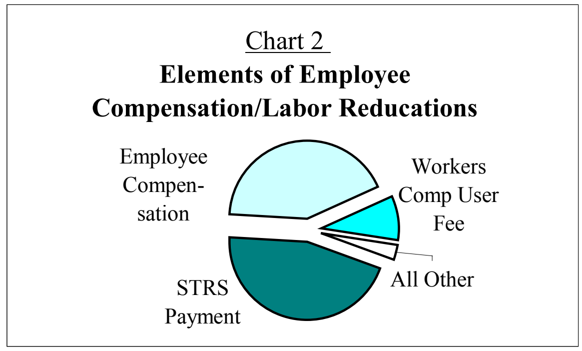
Employee Compensation and Labor

EMPLOYEE COMPENSATION/LABOR





The December Revision reduces employee compensation and labor departments by $1.1 billion, about 11 percent of the total reductions. Of this amount, the two major reductions are associated with reducing employee compensation through a renegotiated contract and deferring a payment to the teachers' retirement fund. Graphs 1 and 2 illustrate these points.

CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM (CALSTRS)

Background

Retirement benefits cannot be reduced for incumbent employees. State constitutional and statutory law has long been interpreted to prohibit the reduction of retirement benefits for incumbent employees. Reductions in retirement benefits can only be made for persons whose employment begins after the adoption of the benefit reduction, thus forming a new "tier" of lower benefits.

In 1980, the State introduced an *optional* second tier featuring sharply reduced benefits. Tier Two requires no employee contributions, but provides benefits that are roughly half those of Tier One. Governor Brown promoted Tier Two as a money-saving measure.

In 1991, legislation provided that Tier Two benefits were made mandatory for newly hired state employees. Governor Wilson demanded the change to mandatory Tier Two membership as part of the budget resolution of that year.

In 1999, legislation provided that Tier Two was returned to an option for new hires. In addition, a window was created for those state employees participating in Tier Two to "buy back" into Tier One. Governor Davis agreed to change Tier Two to optional in response to its continuing unpopularity among state employees.

Savings from adopting a lower tier of benefits are not immediate and are mostly accrued in the future, having a negligible impact on the current budgets.

Relevant Court Cases from the 1980's and 1990's. Four lawsuits from the 1980's and 1990's are relevant to the discussion of the reduction of benefits and employer contributions: *Valdes v. Cory*, 139 Cal. App. 3rd 773 (1982) relating to CalPERS, *CTA v. Cory,* 155 Cal. App. 3rd 494 (1984) relating to CalSTRS, *Claypool v. Wilson,* 4 Cal. App. 4th (1992) relating to CalPERS, and *Board of Administration v. Wilson,* 52 Cal. App. 4th 1109 (1997), relating to CalPERS.

These lawsuits occurred when the State reduced benefits of, or contributions to, the respective retirement systems *without agreement from employee representatives and the Board of Administration of the affected system*.

The basic tenets of the court decisions resulting from these lawsuits are:

a) the State contributions to state-funded retirement systems are protected because employees have a contractual right to an actuarially sound retirement system, and

b) the employer cannot unilaterally reduce retirement benefits without providing some additional benefit of equal value to system members.

Proposition 162 of 1992. As a reaction to years of gubernatorial and legislative meddling with contributions to CalPERS and CalSTRS (which culminated in a major clash with Governor Wilson during the 1991 legislative session), public employee labor organizations sponsored the successful Proposition 162 in 1992.

Proposition 162 provides *constitutional law* specifying that the CalSTRS and CalPERS Boards of Administration have **"plenary authority"** over the administration and investment of the CalSTRS and CalPERS Funds; this absolute authority includes the
annual setting of the rates for required employer contributions to CalPERS.

Absent constitutional amendment, neither the Governor nor the Legislature can control the rate, amount or timing of state contributions to CalSTRS and CalPERS.

December Revision
Revision Reduces CalSTRS Supplement Benefits Maintenance Account (SBMA). CalSTRS provides a *supplemental* purchasing power benefit (SBMA) of 80% of what the members' original retirement check could buy (if adequate resources are available in the CalSTRS Fund). The SBMA benefit is now provided to teachers who retired in the early 1980's or before, whose retirement benefits have been eroded by inflation.

SBMA is funded by an annual General Fund contribution equating to 2.5% of the annual teacher payroll. *While 2.5% is contributed annually, low inflation allows the current SBMA payments to expend just 1%, leaving 1.5% to accumulate in the CalSTRS Fund as a hedge against benefit payment pressures created by future inflation and the demographics of CalSTRS members.* With the 2.5% level funding intact, CalSTRS indicates that the SBMA benefit could be paid *for 36 years*.

The 2.5% funding level of SBMA is considered by CalSTRS to be a vested funding stream, guaranteed by previous legislation to continue indefinitely.

The FY 2003-2004 General Fund contribution to the SMBA benefit is $551 million.

The December Revision reduces the 2003-2004 SBMA contribution to $51 million.

CalSTRS indicates that this proposed reduction would have *no immediate impact on SBMA benefit payments*, but would result in the reduction of the period for which the SBMA is *funded from 36 years to 30 or 31 years,* *assuming the immediate return to the full 2.5% contribution in FY 2004-2005 and future years.*

The Legislative Analyst believes that the proposed reduction in SBMA contribution is probably not legal.

$11 Million Reduction in FY 2002-2003 CalPERS Rural Health Care Equity Program (RHCEP) Payments. Chapter 743 of 1999 (SB 514, Chesbro) provides an RHCEP benefit of **$500/year** to certain CalPERS retirees toward health plan deductibles and copayments *in geographic regions where there is no HMO alternative*. The Governor's Department of Personnel Administration (DPA) administers this program.

Governor Davis has announced that DPA will stop making RHCEP benefit payments on December 31, 2002, saving the General Fund a reported $11 million in the rest of FY 2002-2003. CSEA is working with Senator Chesbro's office to determine if DPA has the authority to unilaterally cancel this benefit.

ALTERNATIVES

Staff suggest consideration of three alternatives:

Alternative 1: Continue the Elimination of State Employees' Contributions to CalPERS Past June 30, 2003.
Rather than providing state employees a 5% pay raise on July 1, 2003, (or permitting a 5% pay cut because of reintroduced CalPERS employee contributions), the least expensive method of maintaining the current level of state employee pay could be to just continue the elimination of employee CalPERS contributions.

Why aren't state employees contributing to CalPERS right now?
State employee contributions are fixed by statute and do not fluctuate to reflect annual actuarial calculations performed by CalPERS. State employer contributions are adjusted each year by CalPERS, based on an actuarial study (discussed below).

However, recent collective bargaining agreements between the state and its 21 bargaining units *reduced* the 5% employee contribution to CalPERS **to**

2.5% (July 1, 2001 to June 30, 2002) **and now 0%** (from July 1, 2002 to June 30, 2003).

When are state employee contributions to CalPERS scheduled to start again? The collective bargaining agreements provide that the employee contributions to CalPERS will be reintroduced beginning July 1, 2003, *coinciding with a 5% increase in state employee salaries*. Without this increase in salaries, state employees would experience a 5% salary decrease caused by the reintroduced CalPERS employee contributions.

What effect does the temporary state employee contribution reduction have on the state's employer contribution, and on the CalPERS Fund itself? During this period of reduction in, or elimination of, employee contributions to CalPERS, employee accounts simply don't grow.

CalPERS conducts an annual actuarial study to examine the state's CalPERS assets on hand (the sum of state employee and employer accounts) compared to its accrued liabilities (the cost of the benefits already earned by active and retired state members) in order to determine the necessary rate of state's employer contributions.

Because CalPERS will recognize the absence of growth in state employee accounts in the annual actuarial study of the state's assets and will, therefore, increase the employer's contribution in an appropriate increment reflecting this situation, there will be no adverse long-term effect on the CalPERS Fund.

Alternative 2: Revise the Method of Funding CalPERS' "Golden Handshake" Offerings

How are CalPERS "Golden Handshakes" currently paid for?
Existing law provides that "Golden Handshake" early retirement offerings must be fully paid within a relatively short period of time: four years. For a $50,000/year employee, the cost of a 2-year service credit only "Gold Handshake" is $25,000 to $27,000. If the cost of the benefit is not fully paid in one year, CalPERS charges the employer interest on the unpaid portion.

Didn't the 2002-2003 Budget include a "Golden Handshake" to encourage state employees to retire early? Governor Davis issued an Executive Order in October permitting state departments to offer a two-year service credit only "Golden Handshake" under the following circumstances:

- it must be paid for up front from departmental budget savings, and

- positions must be eliminated in connection with the adoption of the "Golden Handshake", as approved by the State Department of Finance.

Given these requirements, only several small state departments have chosen to offer the 2-year "Golden Handshake", and *less than 200 state employees total appear to be participating in the offering***.** All of the major state department declined to participate in offering this early retirement incentive to their employees. The Executive Order terminated in November.

Is a 2-year service credit "Golden Handshake" enough of an incentive to get a lot of state employees to leave early? The answer to this question is unclear, since so few state employees were allowed by their departments to choose this early retirement incentive.

Is the position elimination requirement in existing CalPERS law a disincentive to state departments to participate in a "Golden Handshake" offering? Position elimination could be the partial cause of low participation in the recent “Golden Handshake” offering. But based on the negative response of virtually all of the major state departments to the recently offered "Golden Handshake", it is reasonable to conclude that position elimination combined with the up-front funding required by existing CalPERS law clearly has created a disincentive for state departments to offer the “Golden Handshake” as currently constituted.

Alternative 3: Revise Existing CalPERS "Golden Handshake" Provisions

Permit the cost of “Golden Handshakes” to be considered an actuarial liability that can be spread over a longer period of time. (This proposal is the same way other CalPERS’ benefits are financed.)

Allowing the cost of "Golden Handshakes" to be included in the actuarial liability could make affordable early retirement incentives that are strong enough to encourage large numbers of state employees to retire immediately.

This funding approach to "Golden Handshakes" has been included in a CalPERS-sponsored bill, AB 67, introduced December 10, 2002, by Gloria Negrete-McLoed, the Chair of the Assembly Committee on Public Employment, Retirement and Social Security.

Reevaluate the requirement to eliminate positions when offering "golden handshakes." Allowing positions to remain, but be filled with younger, lower-paid employees may be the most cost-effective way to reduce departmental expenses by moving older, higher-paid state employees into retirement.

Reevaluate the incentive provided in the existing two-year service credit only "golden hanshake." What incentive can get large numbers of employees to retire early? Adding years to "age factor" portion of the CalPERS retirement equation (for example, offering a "2 + 2 Golden Handshake" which provides 2 years of additional service credit *PLUS 2 years enhancement of the "age factor"*) would greatly increase the cost. But if such an enhanced "Golden Handshake" can get many higher-paid state employees to leave immediately *and* state CalPERS contributions for it can be spread over a longer time period than currently permitted, these costs may be deemed acceptable.

EMPLOYEE COMPENSATION

The December Revision assumes $470 million in savings associated with reduced employee compensation. To achieve these savings, the Administration intends to re-open Memoranda of Understanding with employee labor units. If the negotiation achieves a settlement the Legislature will have to adopt the terms of the agreement in statutory law.

DEPARTMENT OF INDUSTRIAL RELATIONS (DIR)

DIR is basically a labor law enforcement department, especially impacting the working poor. The December Revision has two proposals:

Impose User Fees for Support of the Workers' Compensation Program. The December Revision imposes user fees (estimated to generate $27.1 million), and reduces by a commensurate amount the General Fund support of the Workers' Compensation Program.

Comments. User-fee support for the workers' compensation program has been an issue for at least two decades. For many years the business community has complained about insufficient program staff to administer and adjudicate claims of injured workers. This user-funding proposal relieves General Fund spending while potentially increasing staffing levels to meet the concerns of the business community.

Recommendation. Adopt December Revision.

Database for the Division of Labor Standards Enforcement (DLSE). The December Revision reduces the 2002 budget by $1 million for implementation of the database.

The Legislature established the database to improve labor and tax compliance. Without the database, the division is unable to track labor law violators. The database should improve labor law enforcement and increase the collection of back wages, and improve tax collection.

Recommendation. Reject December Revision.

OTHER LABOR ISSUES

Although associated with a cut in the higher education budget, staff note that the December Revision reduces the Institute for Labor and Employment (ILE). The institute's labor research has been important to the Department of Industrial Relations, the Labor and Workforce Development Agency, community groups and labor organizations.

The institute, and its related labor centers, was established in 2000 with an annual budget of about $6 million budget. In 2002, the Legislature reduced the budget to $4.9 million. The reduction to UC could be visited on the

institute. The institute indicates that it could lose between $150,000 and $2 million, as its share of the university's reductions.
Impact. A $150,000 cut in unspent funds will mean the cancellation of the summer intern program. A $2 million reduction now, followed by a 10% cut will decimate the program.

Comments. U.C. spends hundreds of millions of dollars each year for industry research, and the ILE is the only program for labor research.

Recommendation. A proportionate share of unspent funds may be necessary to cut. No $2 million cut and no 10% permanent cut.

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